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In the Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-427

KENNETH R. GROVES AND PEGGY L. GROVES,
Petitioners,

VS.

UNITED STATES OF AMERICA,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI FROM THE JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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JURISDICTIONAL GROUNDS

This is a Petition for Writ of Certiorari from the judgment of the United States Circuit Court for the Fifth Circuit rendered June 25, 1976, and reported at 533 F. 2d 1376, affirming the Final Judgment of the United States District Court for the Northern District of Florida, entered on the 21st day of November, 1974, and reported at 35 A. F. T. R. 2d 817. Both of these opinions are appended hereto. This Court has jurisdiction to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit by virtue of U. S. C., Title 28, Sections 1254 and 2101 (C).

QUESTION PRESENTED

Whether the United States Court of Appeals for the Fifth Circuit correctly held that the Government of the Trust Territory of the Pacific Islands is an agency of the United States within the meaning of Section 911 of the Internal Revenue Code of 1974, so that amounts paid to the petitioners-taxpayers by that Government are includable in gross income for United States income tax purposes.

STATUTE INVOLVED

The statute involved is Section 911 of the Internal Revenue Code of 1974 (26 U. S. C.), as amended by Section 11 (a) Revenue Act of 1962, P. L. 87-834, 76 Stat. 960, which statute is set out verbatim in the appendix hereto.

STATEMENT OF THE CASE

The following facts have been stipulated:

Kenneth R. and Peggy L. Groves, taxpayers, filed their joint income tax returns for the years 1970 and 1971 in a timely fashion and paid the full amount shown to be due thereon. Taxpayers then filed claims for refund for both years, seeking a refund of income taxes paid on the premises that the income they had earned was excludable from gross income under Section 911 of the Internal Revenue Code of 1954. Both claims for refund were disallowed by the Internal Revenue Service.

Both of the taxpayers are employed as contract teachers by the Government of the Territory of the Pacific Islands (hereinafter referred to as Trust Territory) and

were so employed during 1970 and 1971. Taxpayers have been contract teachers for the Trust Territory Government since 1967. Every two years, the taxpayers return to the United States for a summer vacation. Other than the returns to the United States for vacation purposes, the taxpayers have been residing within the Trust Territory since 1967.

The Trust Territory is a group of more than 2,000 islands and atolls which are situated in the Western Pacific Ocean and includes the Northern Mariana Islands, the Eastern and Western Caroline Islands and the Marshall Islands. At the end of World War II, the Trust Territory came under the military control of the United States with the defeat of Japan, which had held a mandate over these islands since the end of World War I under the now defunct League of Nations.

The establishment of the United Nations and its Trusteeship Council, with jurisdiction over non-self-governing territories, resulted in the execution of trusteeship agreements between the United Nations and those member nations who were in *de facto* control and possession of such territories following the cessation of hostilities at the end of World War II. The United States accepted administrative responsibility for the people of the Trust Territory through a Trusteeship Agreement with the United Nations Security Council on July 18, 1947. Trusteeship Agreement for the Former Japanese Mandated Islands, 61 Stat. 3301. The Trusteeship Agreement, in which the United Nations designated the United States to be the administering authority of the Trust Territory, states that the United States shall "promote the development of the inhabitants of the Trust Territory toward *self-government.*" Trusteeship Agreement for the Former Japanese Mandated Islands, July 18, 1947, Art. 6 (1) (emphasis added). This is a clear

statement of intent on the part of the United Nations to foster self-government in the Trust Territory.

Administration of the Trusteeship was vested in the President of the United States by Section 1 of the Act of June 30, 1954 (48 U. S. C., Section 1681 (A)). Responsibility for administration of the Trust Territory was divided between the Department of the Interior and the Department of the Navy until 1962, when President Kennedy, by Executive Order No. 11021, redelegated his authority for civil administration of the Trust Territory to the Secretary of the Interior. The Secretary of the Interior delegated Executive Authority to the High Commissioner in Department of Interior Order No. 2918.

Executive and administrative authority for the government of the Trust Territory is vested in a High Commissioner who is appointed by the Secretary of the Interior. Certain legislative authority has been transferred from the High Commissioner to the Congress of Micronesia, the members of which are elected by citizens of the Trust Territory. The judicial branch consists of the High Court of the Territory with the Chief Justice and Associate Justice being appointed by the Secretary of the Interior.

Employees of the Trust Territory Government are paid by payroll check drawn upon the general fund of the Trust Territory, which funds are composed of both United States grant funds and locally generated revenues. The employment of teachers by the Trust Territory Government is the joint obligation of the Director of the Department of Education and the Director of Personnel pursuant to provisions of the Trust Territory Code, and the Trust Territory Government has sole control of the Department of Education and the hiring of teachers, as well as the determination of the amounts of salaries for teachers employed by the Trust Territory Government.

The Trust Territory School System is governed by the policies and standards of the Micronesian Board of Education and Trust Territory Code Title 41. The Trust Territory Code contains laws enacted by the Congress of Micronesia, a body elected by the Trust Territory citizens. The Board of Education is appointed by the High Commissioner with the advice and consent of the Congress of Micronesia.

The taxpayers instituted suit in the United States District Court for the Northern District of Florida seeking a refund of the taxes that they had paid for the years 1970 and 1971. After the parties had stipulated as to all factual questions, including the fact that the taxpayers met all requirements of Section 911, the United States District Court for the Northern District of Florida decided that the Trust Territory Government is an agency of the United States Government for purposes of Section 911 of the Internal Revenue Code and thus dismissed the taxpayers' suit.

Thereupon, the taxpayers filed their appeal to the United States Court of Appeals for the Fifth Circuit. After the parties had submitted briefs and presented oral arguments, the United States Court of Appeals for the Fifth Circuit affirmed the decision of the United States District Court for the Northern District of Florida in its opinion holding that the Trust Territory Government is an agency of the United States Government for purposes of Section 911 of the Internal Revenue Code. The basis for Federal jurisdiction in the court of first instance, the United States District Court for the Northern District of Florida, was U. S. C., Title 28, Section 1346 (a). After the decision of the United States Court of Appeals for the Fifth Circuit was rendered, the taxpayers filed this Petition for Writ of Certiorari.

ARGUMENT

The United States Court of Appeals for the Fifth Circuit has decided an important question of federal law which has not been, but should be, settled by this Court. Such a decision by a United States Court of Appeals is one of the grounds contained in Rule 19 of the Supreme Court Rules governing Jurisdiction on Writ of Certiorari. Not only is the decision of the Circuit Court of Appeals a decision on an important question of federal law, it is also a decision affecting the status of a Trust Territory created by the United Nations.

There are at least two other cases pending in which the identical issue is involved; one is in the United States Court of Appeals for the Ninth Circuit (*John D. McComish & Genevieve A. McComish* v. *Commissioner of Internal Revenue,* on appeal from the decision of the United States Tax Court reported at 64 T. C. 87) and the other case is pending in the Tax Court in Hawaii (*Cushmie* v. *Commissioner,* T. C. No. 2673-73).

There may be many other similar cases pending of which we are not aware, but we are aware of certain taxpayers who are now in the administrative process claiming refunds due from the Internal Revenue Service. For example, Leonard J. Kaufer with the Department of Education on Saipan, Mariana Islands, is in such a contest as evidenced by his letter to the petitioners' attorneys of January 25, 1976, appended hereto. Also appended hereto are copies of letters from other taxpayers and attorneys for other taxpayers inquiring with great interest as to the status of this case.

The Trust Terrritory Government is itself very interested in a definitive ruling on this important question

as evidenced by the following correspondence from Trust Territory officials which are appended hereto:

1. Letter of June 21, 1974, from Richard I. Miyamoto, Attorney General of the Trust Territory of the Pacific Islands.

2. Letter of September 27, 1974, from Leo McShane, Public Defender, Saipan, Mariana Islands.

3. Letter of February 20, 1976, from Gerald L. Seck, Directing Attorney—Truk Office, Law Offices of Micronesian Legal Services Corporation.

4. Letter of April 18, 1975, from Jack Layne, District Attorney, Truk, Eastern Caroline Islands.

The question presented in this petition is not only an important question of federal and international law, but is also a question never before addressed by this Court. Indeed, in the opinion of the United States Court of Appeals for the Fifth Circuit, it was noted at page 4277 that the Court was without guidance even "from the usual sources of legislative history—committee reports, hearings, and debates reported in the Congressional records."

With regard to the question of agency, the United States Department of the Interior, the department responsible for administration of the Trusteeship, has expressed its opinion that the Government of the Trust Territory is not an agency of the United States. *See* letter from the Office of the Solicitor, United States Department of the Interior, to Honorable Henry M. Jackson, reported in *Management of Public Works Programs in the Trust Territory of the Pacific Islands,* a staff report prepared at the request of Henry M. Jackson, Chairman, Committee on Interior and Insular Affairs, United States Senate, 94th Congress, 1st Session, 1975 (a copy

is appended hereto). The letter points out that the Trusteeship Agreement allows the U. S. to extend its laws to Micronesia, but that this provision is not self-executing and that "U. S. laws must be specifically extended to Micronesia by the U. S. Congress before they will be applicable there." (p. 289). The letter continues to state "[t]here are an additional 462 U. S. citizens employed under contract by the Trust Territory Government. These are Trust Territory—not Federal—employees and are in no way related to the Federal establishment." (p. 290).

Citing the decisions in *Porter* v. *United States,* 496 F. 2d 583, and *People of Saipan* v. *United States Department of Interior,* 502 F. 2d 90, the staff report concluded: "The courts have held that the Government of the Trust Territory as established by the Secretary is not an agency or instrumentality of the Federal Government, but is a separate and distinct legal entity with semi-sovereign powers to sue, be sued, and to contract in its own right and name." (p. 46).

It is within the realm of Congress, and not the courts, to specifically extend the term "agency" to include the Government of the Trust Territory. The United States Court of Appeals for the Fifth Circuit has usurped the power of Congress by extending Section 911 to affect the Government of the Trust Territory. Congress has not chosen to so extend the meaning of the term "agency" and there is no regulation defining the word agency as used in Section 911, or extending the term to include the Government of the Trust Territory as an agency of the United States Government. The question of whether the Government of the Trust Territory is an agency of the United States Government for purposes of Section 911 should be resolved by this Court. The multiplicity of existing and contemplated law suits and the keen interest

of the Trust Territory Government itself as well as the interest of the Department of the Interior in the answer to this vital question justifies this Court in granting the Petition for Writ of Certiorari.

Petitioners respectfully request that this Court grant the Petition for Writ of Certiorari.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that the foregoing petition has been mailed to opposing counsel duly addressed to their offices, and to the Solicitor General, Department of Justice, Washington, D. C. 20530, with proper postage affixed thereto, this 21st day of September, 1976.

H. EDWARD MOORE, JR., of
SHERRILL & MOORE
P. O. Box 1792
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Attorney for Petitioners

APPENDIX

Kenneth R. GROVES and Peggy L. Groves,
Plaintiffs-Appellants,

v.

UNITED STATES of America,
Defendant-Appellee.

No. 74-4219.

United States Court of Appeals,
Fifth Circuit.

June 25, 1976.

Taxpayers brought suit for refund of federal income taxes on ground that income earned as teachers employed by the government of the trust territory of the Pacific Islands was excludable from gross income. The United States District Court for the Northern District of Florida at Pensacola, Winston E. Arnow, Chief Judge, entered judgment in favor of the Government and taxpayers appealed. The Court of Appeals, Miller, Associate Judge, sitting by designation, held that government of the trust territory is an agency of the United States for purposes of statute excluding from gross income earned income from sources without the United States except amounts paid by a United States agency, and exclusion was not applicable.

Affirmed.

1. Federal Civil Procedure (Key) 1593

Inasmuch as the sole issue to be decided in suit for refund of federal income taxes was one of law, and facts had been stipulated, taxpayers' motion to compel produc-

tion of government files was properly denied. Fed.Rules Civ. Proc. rule 26(b)(1), 28 U.S.C.A.

2. Internal Revenue (Key) 1202

District Court, in suit for refund of income taxes, committed no error, let alone prejudicial error, in giving respectful consideration to revenue ruling.

3. Internal Revenue (Key) 315

Taxpayers employed as teachers by the government of the trust territory of the Pacific Islands came within legislative purpose of statute excluding from gross income earned income from sources without the United States. 26 U.S.C.A. (I.R.C.1954) §§ 911, 911(a)(1); 48 U.S.C.A. § 1681(a); Joint Resolution July 18, 1947, 61 Stat. 397; Trusteeship Agreement for the former Japanese Mandated Islands, art. 6, sub. 1, 61 Stat. 3301.

4. Internal Revenue (Key) 183

Provisions granting tax exemptions are to be strictly construed.

5. Internal Revenue (Key) 315

The word "agency," in statute excluding from gross income earned income from sources without the United States except amounts paid by the United States or any agency thereof, is to be broadly construed. 26 U.S.C.A. (I.R.C.1954) §§ 911, 911(a)(1).

6. Internal Revenue (Key) 315

In using the word "agency" in statute providing for exclusion from gross income of earned income from sources without the United States except amounts paid by the

United States or any agency thereof, Congress contemplated an entity which is a means of carrying out a governmental function of the United States.

7. Internal Revenue (Key) 315

Although the trusteeship agreement under which the United States administers the trust territory of the Pacific Islands provides that the administering authority shall promote the development of the inhabitants of the territory toward self-government or independence, the United States, as administering authority, is carrying out a governmental function and government of the trust territory is an "agency" of the United States for purposes of statute excluding from gross income earned income from sources without the United States except amounts paid by any agency of the United States even if trust territory government did not have authority to bind the United States to contract and had sovereignty to levy taxes. 26 U.S.C.A. (I.R.C. 1954) §§ 911, 911(a)(1); Trusteeship Agreement for the former Japanese Mandated Islands, arts. 1, 6, 15, 61 Stat. 3301; United Nations Charter, arts. 27, 76, 76, subd. 83, 59 Stat. 1035.

See publication Words and Phrases for other judicial constructions and definitions.

8. Internal Revenue (Key) 315

Sovereignty of government of the Trust Territory of the Pacific Islands is not the touchstone of power and responsibility for carrying out a governmental function of the United States for purpose of determining whether the trust territory government is an agency of the United States so as to render inapplicable the exclusion of gross income for earned sources without the United States. 26 U.S.C.A. (I.R.C.1954) §§ 911, 911(a)(1).

Appeal from the United States District Court for the Northern District of Florida.

Before BROWN, Chief Judge, THORNBERRY, Circuit Judge, and MILLER,* Associate Judge.

MILLER, Associate Judge:

This appeal is from the judgment of the district court in favor of the United States, dismissing appellants' suit for refund of federal income taxes for the calendar years 1970 and 1971, which was based on disallowance of their claims for refund by the Internal Revenue Service. Appellants' earned income for the years involved consisted of salaries paid them by the Government of the Trust Territory of the Pacific Islands (GTTPI), and the ultimate question is whether, as appellants maintain, this income was excludable from gross income under subsection 911(a)(1) of the Internal Revenue Code of 1954 (I.R.C.), as amended (26 U.S.C. § 911(a)(1)).[1] This question turns

*Of the United States Court of Customs and Patent Appeals, sitting by designation.

1. Section 911 (as amended by section 11(a), Revenue Act of 1962, Pub.L.No.87-834, 76 Stat. 1003-04) provides in part as follows:

> § 911. *Earned income from sources without the United States*
>
> (a) General rule.—The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:
>
> (1) *Bona fide resident of foreign country.*—In the case of an individual citizen of the United States who establishes to the satisfaction of the Secretary or his delegate that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during such uninterrupted period. The amount excluded under this paragraph for any taxable year shall be computed by applying the special rules contained in subsection (c).

on whether, as the district court held the GTTPI is an agency" of the United States for purposes of that subsection. We affirm.

Facts

There is no dispute that appellants meet the residence requirements of subsection 911(a)(1) for both 1970 and 1971. Pertinent stipulated and undisputed facts, as found by the district court, are as follows:

Taxpayers, husband and wife, were both employed during the years involved as contract teachers by the GTTPI. The Trust Territory is a group of more than 2,000 islands and atolls situated in the Western Pacific Ocean. It includes the Northern Mariana Islands, the Eastern and Western Caroline Islands, and the Marshall Islands.[2] Between World War I and World War II the group was under control of Japan, which held a mandate over it under the old League of Nations. At the end of World War II, the group was under the military control of the United States, and this continued until the United Nations established a Trusteeship Council, which had jurisdiction over non-self-governing territories, including the Trust Territory of the Pacific Islands. Trusteeship agreements were entered into between the United Nations and those member nations which were in de facto control and possession of such territories. One of these agreements, effective July 18, 1947, was between the United Nations Security Council and the United States, which accepted administrative responsibility for the people of the Trust Territory of the Pacific Islands. Congress, by joint resolution, authorized the President to approve this agreement. Joint Resolution of July 18, 1947, ch. 271, 61 Stat. 397.

2. The group is also known as "Micronesia." *Yearbook of the United Nations* 613 (1967 ed.) (United Nations Publication).

Under the Trusteeship Agreement, the United States, as the administering authority, was granted full powers of administration, legislation, and jurisdiction over the Trust Territory in order to promote the objectives of the United Nations, namely, the development of the economic social, political and educational well-being of the people of the Trust Territory.[3] Administration of the trusteeship was vested in the President of the United States by section 1 of the Act of June 30, 1954, ch. 423, 68 Stat. 330 (48 U.S.C. § 1681(a)), wherein it was directed—

> That until Congress shall further provide for the government of the Trust Territory of the Pacific Islands, all executive, legislative, and judicial authority necessary for the civil administration of the Trust Territory shall continue to be vested in such person or persons and shall be exercised in such manner and through such agency or agencies[4] as the President of the United States may direct or authorize.

Responsibility for administration of the Trust Territory was divided between the United States Department of Interior and the Department of the Navy until 1962, when President Kennedy by Executive Order No. 11021, 3 CFR 600 (1959-63 comp.), 48 U.S.C. § 1681, redelegated his authority for civil administration of the

3. The Trusteeship Agreement provides that the United States shall "promote the development of the inhabitants of the trust territory toward self-government." Trusteeship Agreement for the former Japanese Mandated Islands, July 18, 1947, Art. 6(1), 61 Stat. 3302, T.I.A.S. No. 1665.

4. As of June 30, 1954, the person and "agency" exercising the authority were the Secretary of the Navy and the Navy Department with respect to the Northern Mariana Islands (except the Island of Rota) and the Secretary of the Interior and the Department of the Interior with respect to all of the remainder of the Trust Territory. Exec.Order No. 10470, July 17, 1953, 3 CFR 951 (1949-53 comp.).

Trust Territory exclusively to the Secretary of the Interior. Pursuant to this authority, the Secretary of the Interior established the Trust Territory Government, which included legislative, judicial, and executive branches similar to the governmental organization of the United States. Department of Interior Order No. 2918.

The Executive Branch of the Trust Territory carries out its responsibilities through the High Commissioner of the Trust Territory. The High Commissioner is appointed by the President of the United States with the advice and consent of the Senate. Act of May 10, 1967, Pub.L.No.90-16, § 2, 81 Stat. 15 (48 U.S.C. § 1681a).

The legislature of the Trust Territory is known as the "Congress of Micronesia" and consists of two houses, the Senate and the House of Representatives. The legislative powers extend over all subjects of the islands except that these powers are limited in that they may not be inconsistent with treaties or international agreements of the United States, laws of the United States applicable to the Trust Territory, Executive Orders of the President of the United States, and orders of the Secretary of the Interior. The legislature has general legislative authority except as specifically restricted by the Secretary of the Interior. Department of Interior Order No. 2918, pt. III.

Every bill which is passed by the Congress of Micronesia has to be presented to the High Commissioner. If the High Commissioner should veto any bill, it is then returned to the Congress. If repassed over his veto, the High Commissioner, if he still does not approve of the bill, must send the bill, with his comments, to the Secretary of the Interior, who then shall either approve or disapprove of the bill regardless of the recommendations

and action taken by the Congress of Micronesia. Department of Interior Order No. 2918, pt. III, Section 13.

The judicial branch of the Trust Territory consists of the High Court for the Trust Territory and such other courts as may be established pursuant to law. The High Court consists presently of a Chief Justice and two Associate Justices, who are appointed by the Secretary of the Interior. Department of Interior Order No. 2918, pt. IV.

Appellants, like other employees of the Trust Territory Government, are paid by checks drawn on the General Fund of the Trust Territory, which fund is composed of both United States grant funds and locally generated revenues. The Trust Territory Government has control of its Department of Education and the hiring of teachers and salaries paid them.[6] United States citizens employed by the Trust Territory Government are taxed by it, with the amount based on the gross income of the taxpayer.

Preliminary Issues

[1] Appellants argue that the trial court erred in denying their motion to compel the production of "any and all files of the Internal Revenue Service or any other United States Government files relating to Revenue Ruling 68-608 and the reasons for any rationale

5. No instance has been called to our attention where this has occurred. However, the High Commissioner has vetoed bills rather frequently. For example, in 1972, he approved 52 and vetoed 10. 26th Annual Report to the United Nations on the Administration of the Trust Territory of the Pacific Islands (1973).

6. The Trust Territory School System is governed by the policies and standards of the Micronesia Board of Education and Trust Territory Code Title 41. The Trust Territory Code contains laws enacted by the Congress of Micronesia, a body elected by the Trust Territory citizens. The Board of Education is appointed by the High Commissioner with the advice and consent of the Congress of Micronesia.

behind that ruling,"[7] stating that they relied upon the Federal Rules of Civil Procedure for purposes of discovery. The Government responds that since the sole issue to be decided is one of law, the facts having been stipulated, discovery was properly denied because the materials sought were not relevant, as required by Rule 26(b)(1), Fed.R.Civ.P. We agree.

[2] Appellants also argue that the trial court erred in citing Revenue Ruling 68-608 and in according any weight to it, citing *Commissioner of Internal Revenue v. P. G. Lake, Inc.*, 356 U.S. 260, 78 S.Ct. 691, 2 L.Ed.2d 743 (1958). We note that the trial court stated that the ruling "is not controlling," although it added that "it is not without weight and is entitled to respectful consideration." We find no error, let alone prejudicial error, in the trial court's position. If anything the cited case supports the trial court by its reference to an administrative agency's "continuing rule-making power" (citing *Helvering v. Reynolds*, 313 U.S. 428, 432, 61 S.Ct. 971, 85 L.Ed. 1438 (1941). *Id.* n. 5. In any event, the position the Government takes on the ruling in its brief should satisfy appellants:

> [It] is simply a published statement of the Commissioner's view that as a matter of law the Trust Territory Government is an agency of the United States within the intendment of Section 911 of the Code . . . .

The Government does not argue that it was brought to the attention of the Congress and that successive revenue

7. Rev.Rul. 68-608, 1968-2 Cum.Bull. 309, holds that employees of the Trust Territory Government who are citizens of the United States must include income received from that government in their gross income because they "are paid by 'the United States or any agency thereof' for the purpose of section 911 of the Code . . . ."

acts of the Congress leaving subsection 911(a)(1) unchanged constitute implied approval.

Citing Treas.Reg. § 1.911-2(a)(1) (1963), the Government states that for appellants' income to be excluded three tests must be satisfied: the amounts must be—

(i) from sources without the United States,

(ii) attributable to such uninterrupted period [which includes an entire taxable year], and

(iii) not paid by the United States or any agency or instrumentality thereof.

It then says (Br. at 13):

> It is uncontroverted here that the taxpayers meet the first two tests . . . .

However, the Government calls attention to the fact that "well over ninety percent of all funds expended by the Trust Territory Government are provided by appropriations and grants from the United States" and incorporates a table in its brief showing that approximately 98% and 94%, respectively, for the years 1971 and 1972, represent the portion of such appropriations and grants. Nevertheless, we accept the Government's position that the amounts of income here involved were "from sources without the United States."[8]

Citing legislative history of the Revenue Acts of 1926 and 1932, the Government makes the following statement:

> The legislative history of Section 911 makes clear that the exemption from taxation was thought necessary by Congress to put citizens of this country trading in foreign countries on an equal footing with traders from other countries. Congress never intended that Section 911 would be used to exclude from federal taxation payments to citizens of this country . . . who do not compete in foreign commerce or further United States business interests.

8. The Comptroller General has ruled that funds appropriated in the nature of unconditional grants to the Trust Territory, when paid to the Trust Territory Government and mingled with local revenues, lose their character as public funds. Op.Comp. Gen. June 11, 1957, B-131569.

However, a more comprehensive review of legislative history does not support that statement.

The original precursor of subsection 911(a)(1)[9] was subsection 213(b)(14) of the Revenue Act of 1926, ch. 27, 44 Stat. 26, which provided:

> (14) In the case of an individual citizen of the United States, a bona fide nonresident of the United States for more than six months during the taxable year, amounts received from sources without the United States if such amounts constitute earned income . . . but such individual shall not be allowed as a deduction from his gross income any deductions properly allocable to or chargeable against amounts excluded from gross income under this paragraph.

The purpose of this subjection was stated by the House Ways and Means Committee (H.R.Rep.No.1, 69th Cong., 1st Sess. 7 (1925)) in terms of foreign trade:

> In an endeavor to take one further step toward increasing our foreign trade it is recommended in this paragraph that there shall be excluded from gross income in the case of our *citizens employed abroad in selling our merchandise* amounts received as salary or commission for the sale for export of tangible personal property produced in the United

9. See note 1 *supra*.

> States in respect of such sales made while they are actually employed outside the United States, if they are so employed for more than six months during a taxable year. [Emphasis added.]

Referring to this provision in the House-passed bill (H.R. 1), the Senate Finance Committee said (S.Rep.No. 52, 69th Cong., 1st Sess. 20-21 (1926)):

> The committee sees no reason for such an exemption, inasmuch as a citizen so employed abroad, if required to pay any income tax to the foreign country on his salary, receives a credit against his United States tax of the amount of tax paid to the foreign country.

However, the House provision was restored by the Conference Committee. H.R.Rep.No.356, 69th Cong., 1st Sess. (Amend. No. 19) (1926).

This subsection became section 116(a) of the Revenue Act of 1932, ch. 209, 47 Stat. 204. It was contained in the House-passed bill (H.R. 10236), but was deleted by the Senate Finance Committee (S.Rep.No.665, 72d Cong., 1st Sess. 31 (1932)), which commented:

> Your committee believes there is no reason for the continuance of this exemption in the case of citizens of the United States residing abroad for the reason that under other sections of the act such citizens are granted a credit for income taxes paid foreign countries and should not be further relieved from Federal income taxes. Furthermore, a considerable proportion of the individuals previously benefited by this subsection have been employees of the United States who, because of their status as such, were usually exempt from any foreign tax upon their

> compensation received from the United States; these citizens are not believed by your committee to be entitled to a complete exemption from the Federal income tax upon such compensation.

However, the Conference Committee restored the provision and, in response to the concern expressed by the Senate, inserted, without elaboration, the parenthetical matter "(except amounts paid by the United States or any agency thereof)." H.R.Rep.No.1492, 72d Cong., 1st Sess. (Amend. No. 59) (1932). During the Senate debate, Senator Reed had unsuccessfully sought to restore the provision deleted by the Finance Committee, but modified to include the parenthetical matter. He said (75 Cong.Rec. 10410 (1932)):

> In order to help our foreign trade and to put *all Americans who are working abroad* in a position of equality with their competitors, the Congress in several successive tax bills has exempted from our income taxes that part of the earnings of those Americans which was earned abroad, provided they lived abroad more than six months out of the year. [Emphasis added.]

The original precursor of subsection 911(a)(2)[10] was subsection 116(a)(2) of the Internal Revenue Code of 1939, as amended by section 148 of the Revenue Act of 1942, ch. 619, 56 Stat. 842. It provided an exclusion from taxable income as follows:

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10. The following exclusion from taxable income is provided by subsection 911(a)(2):

> (2) *Presence in foreign country for 17 months.*—In the case of an individual citizen of the United States who during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during such 18-month period. . . .

(2) *Taxable year of change of residence to United States.*—In the case of an individual citizen of the United States, who has been a bona fide resident of a foreign country or countries for a period of at least two years before the date on which he changes his residence from such country to the United States, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof), which are attributable to that part of such period of foreign residence before such date, if such amounts would constitute earned income as defined in section 25(a) if received from sources within the United States; but such individual shall not be allowed as a deduction from his gross income any deductions properly allocable to or chargeable against amounts excluded from gross income under this subsection.

It should be noted that this new subsection contained the identical parenthetical matter inserted in section 116(a) of the Revenue Act of 1932 which subsequently became section 116(A)(1) of the Internal Revenue Code of 1939. The House-passed bill (H.R. 7378) would have repealed section 116(a) outright. H.R.Rep.No.233, 77th Cong., 2d Sess. 93 (1942). However, the Senate Finance Committee, noting the proposed repeal and recognizing that abuses had occurred, said that outright repeal would work hardship. "For example, many employees of American business in South America do not return to the United States for periods of years. Such persons are fully subject to the income tax of the foreign country of their residence." It said that the provision (concerning length of residency) would eliminate abuse, but "will not unduly penalize our citizens who are bona fide residents of foreign countries." S.Rep.No.1631, 77th Cong., 2d Sess. 54 (1942). The Conference Committee adopted the Senate position. H.R.Rep. No.2586, 77th Cong., 2d Sess. (Amend. No. 128) (1942).

[3] Section 321 of the Revenue Act of 1951, ch. 521, 65 Stat. 498, continued section 116(a) although the House-passed bill (H.R. 4473) had dropped it. In restoring it, the Senate Finance Committee (S.Rep.No.781, 82d Cong., 1st Sess. 52-53 (1951) U.S.Code Cong. & Admin.News, p. 2023) said:

> Section 116(a) of the code exempts from income tax citizens of the United States who are bona fide residents of a foreign country with respect to income earned outside the United States, and disallows deductions chargeable against this income. This provision is intended both to encourage citizens to go abroad and to place them in an equal position with citizens of other countries going abroad who are not taxed by their own countries.

The Conference Committee adopted the Senate position. H.R.Rep.No.1213, 82d Cong., 1st Sess. (Amend. No. 55) (1951). Thus, the narrow purpose first expressed in 1926 of making our foreign traders located overseas competitive, taxwise, had been broadened by 1951 to making all citizens residing and earning income outside the United States competitive, taxwise. *See Swenson v. Tomas,* 164 F.2d 783, 784 (CA 5 1947). No subsequent change in this purpose has been brought to our attention, and, therefore, we conclude that appellants, earning their foreign source income as teachers, come within the legislative purpose, provided the amounts they received were not from an "agency" of the United States.

Main Issue—"Agency" of the United States

[4, 5] In determining the meaning of "agency" of the United States for purposes of subsection 911(a)(1),

I.R.C., we are without guidance from the usual sources of legislative history—committee reports, hearings, and debates reported in the Congressional Record. However, our approach must follow the long-recognized rule that provisions granting tax exemptions are to be strictly construed. *Commissioner of Internal Revenue v. Jacobson*, 336 U.S. 28, 69 S.Ct. 358, 93 L.Ed. 477 (1949); *Lutkins v. United States*, 312 F.2d 803, 160 Ct.Cl. 648, *cert. denied*, 375 U.S. 825, 84 S.Ct. 65, 11 L.Ed.2d 57 (1963); *M. C. Parrish & Co. v. Commissioner of Internal Revenue*, 147 F.2d 284 (CA 5 1945). In the case of section 911, I.R.C., this means that the word "agency" is to be broadly construed, absent a contrary intent manifested by Congress, since a narrow construction thereof would be incompatible with a strict construction of the exemption.

Webster's New International Dictionary of the English Language (2d ed. 1939), which would indicate the common understanding of the meaning of the words at the time the identical parenthetical matter was included in subsection 116(a)(2) of the Internal Revenue Code of 1939 by the Revenue Act of 1942, discussed above, defined "agency" as follows:

> 1. Faculty or state of acting or of exerting power; . . . instrumentality.
>
> 2. Office or function of an agent, or factor; relation between a principal and his agent; business of one entrusted with the concerns of another. . . .

The word "instrumentality" was defined thus:

> Quality or state of being instrumental; that which is instrumental; means; medium; agency.

The first Treasury Department regulation interpreting the above-referred-to parenthetical matter was § 29.116-1 of Income Tax Regulations 111, promulgated in 1943 and

applicable to years beginning after December 31, 1941. It specified the tests to be met, including one substantially identical to test (iii) in the present regulation § 1.911-2(a)(1) (1963), namely:

> such income does not represent amounts paid by the United States or any agency or instrumentality thereof.

Thus, "instrumentality" was equated with "agency," and the long-continued existence of this provision in successive regulations, without disapproval by Congress, indicates tacit approval of Congress thereof.

[6] At the same time, since the United Nations was not established until 1945 and the Trusteeship Agreement involved here was not effectuated until 1947, it could hardly be said that the GTTPI was specifically contemplated by the Congress at the time of enactment of the Revenue Act of 1942. What can be said is that Congress contemplated an entity which is a means of carrying out a governmental function of the United States. Construing "agency" or "instrumentality" broadly in such terms would encompass functions which fall within the responsibility of the United States, whether that responsibility and its correlative power derive from sovereignty or from a trusteeship agreement.[11] The substance of the functions under

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11. We note the provision, quoted above, in the Act of June 30, 1954, that the civil administration of the Trust Territory "shall continue to be vested in such person or persons and shall be exercised in such manner and through such agency or agencies as the President of the United States may direct or authorize." The Trust Government, authorized by the Secretary of the Interior by delegated authority from the President, is clearly the "agency" through which the civil administration of the Trust Territory is exercised. This has been recognized by the High Court of the Trust Territory itself, which stated:

> Furthermore, the Trust Territory Government seems clearly intended to come within the meaning of the words "such agency or agencies as the President of the United States may direct or authorize" as used in 48 U.S.C. 1681(a) in providing for the government of the area.

Alig v. Trust Territory, 3 TTR 603, 612-13 (App.Div.1967).

the Trusteeship Agreement involved here is underscored by the broad powers provided for by Article 3 of the Trusteeship Agreement:

> The administering authority shall have full powers of administration, legislation, and jurisdiction over the territory subject to the provisions of this agreement, and may apply to the trust territory, subject to any modifications which the administering authority may consider desirable, such of the laws of the United States as it may deem appropriate to local conditions and requirements.

[7] It is correct, as appellants point out, that the Trusteeship Agreement provides (Art. 6.) that the administering authority shall "promote the development of the inhabitants of the trust territory toward self-government or independence, as may be appropriate to the particular circumstances of the trust territory and its peoples and the freely expressed wishes of the peoples concerned." However, that the end objective is specified by the Trusteeship Agreement and by Article 76(b) of the Charter of the United Nations[12] does not gainsay the fact that the United States, as administering authority, is carrying out

12. Article 76, 59 Stat. 1048-49, T.S. 993, provides:

> The basic objectives of the trusteeship system, in accordance with the Purposes of the United Nations laid down in Article 1 of the present Charter, shall be:
>
> a. to further international peace and security;
>
> b. to promote the political, economic, social, and educational advancement of the inhabitants of the trust territories, and their progressive development towards self-government or independence as may be appropriate to the particular circumstances of each territory and its peoples and the freely expressed wishes of the peoples concerned, and as may be provided by the terms of each trusteeship agreement. . . .

a governmental function—discharging a responsibility—directed to attainment of that objective.[13]

Appellants argue that the employment of teachers is the responsibility jointly of the Director of the Department of Education and the Director of Personnel, and that the Trust Territory Government has sole control of the Department of Education and the hiring of teachers. This overlooks the fact that under Part III, Section 4, of the Trust Territory Code, requests for federal funds must be submitted to the Secretary of the Interior. He, in turn, must rely upon appropriations by the Congress. Considering the high percentage of the expenditures of the Trust Territory Government which comes from the United States as administering authority, it would be unrealistic to deny the existence of control over the Trust Territory Government and its system of education, granted that the "daily administration of the islands" has been "largely shifted into the hands of the local government." (Appellants' Br. 9.)[14]

13. It is to be noted that Article 15 of the Trusteeship Agreement states: "The terms of the present agreement shall not be altered, amended or terminated without the consent of the administering authority." The Trust Territory of the Pacific Islands is a "strategic area" (Art. 1, Trusteeship Agreement), and, therefore, functions of the United Nations with respect to it are exercised by the Security Council (Art. 83, Charter of the United Nations, 59 Stat. 1050), in which the United States possesses a veto (Art. 27, *id.* at 1041).

14. There is no basis here for applying the doctrine that substance governs over form. Apart from the role of Congressional appropriations, control over the Trust Territory Government provided for in the Trusteeship Agreement has been exercised on a continuing basis by the Secretary of the Interior. See, for example, Dept. of Interior Orders 2902, 32 Fed.Reg. 16058 (1967); 2918, 34 Fed.Reg. 157 (1968); 2969, 40 Fed.Reg. 811 (1975); 2973, 40 Fed.Reg. 17300 (1975); and 2980, 41 Fed.Reg. 15892 (1976). The Government argues: "There can be no doubt that the government of the Trust Territory could be dissolved pursuant to the authority of the United States." This overstates the case. Such a possibility is more theoretical than real. What matters is that the Trust Territory Government is the means of carrying out a governmental function of the United States.

Appellants rely on *People of Saipan v. United States Department of Interior*, 502 F.2d 90 (CA 9 1974), *cert. denied*, 420 U.S. 1003, 95 S.Ct. 1445, 43 L.Ed.2d 761 (1975), which affirmed the district court's conclusions that (a) the Trust Territory Government is not an "agency" for purposes of review under the Administrative Procedure Act (APA), 5 U.S.C. § 701 et seq., and (b) therefore it is not an "agency" for purposes of the National Environmental Policy Act, 42 U.S.C. § 4321 et seq. Although not a territory or possession (these are specifically excluded from the definition of "agency" under the APA), the Trust Territory Government was considered by the court to come within the intent of Congress "to exclude from APA review all governments of this general type created pursuant to the authority of Congress." The rationale of the court's position was stated as follows:

> This clear statement of intent on the part of the United Nations to foster self-government in the Trust Territory constrains us not to hold that the actions of the local government are reviewable in the same manner as the actions of domestic federal administrative agencies, in a federal district court several thousand miles from the islands.

The court also said:

> Plaintiffs have cited several judicial decisions, a regulation, and one Tax Court decision stating that the Trust Territory is not a territory or possession of the United States. However, the holding of the judicial decisions is limited to the applicability of the Federal Tort Claims Act (*see, e. g., Callas v. United States*, 253 F.2d 838 (2d Cir.), cert. denied, 357 U.S. 936, 78 S.Ct. 1384, 2 L.Ed.2d 1550 . . . and the regulation and the Tax Court decision both involve federal income taxation. . . . We do not read these decisions

> and the regulation to be inconsistent with our conclusion that Congress intended the government of the Trust Territory, like that of territories and possessions, to be immune from judicial review under the APA.

Thus, the court stated, in effect, that its position is not a precedent in cases involving other statutes, including particularly those relating to income taxation.

Appellants also rely on *Porter v. United States*, 496 F.2d 583, 204 Ct.Cl. 355 (1974), *cert. denied*, 420 U.S. 1004, 95 S.Ct. 1446, 43 L.Ed.2d 761 (1975), which held that the Trust Territory Government was not an agency of the United States acting within the scope of its authority in entering into the contract in dispute, so that the United States was not bound as principal by the contract, which had been negotiated by officials of the Trust Territory Government. The court pointed out that the jurisdictional issue involved turned on privity of contract rather than statutory construction. We agree with the Government's contention that, as in the *People of Saipan* case, *Porter* cannot serve as precedent for interpreting a federal tax statute. Obviously it is not necessary that the Trust Territory Government have authority to bind the United States to a contract in order for it to be the means of carrying out a governmental function of the United States. *Cf. Standard Oil Co. v. Johnson*, 316 U.S. 481, 62 S.Ct. 1168, 86 L.Ed. 1611 (1942).

Relevant to interpretation of a tax statute is the opinion of the Court of Claims in *Morse v. United States*, 443 F.2d 1185, 195 Ct.Cl. 1 (1971), *cert. denied*, 405 U.S. 989, 92 S.Ct. 1251, 31 L.Ed.2d 455 (1972). The court held that the United States Employees Association of Tehran, Iran, which hired the taxpayer to serve as an assistant manager and which was organized under authority of State Department regulations to provide for its members and

their dependents recreational activities and a source of food and other items at minimum prices, was an "agency" under subsection 911(a)(2), I.R.C. It quoted from *Donaldson v. Commissioner of Internal Revenue*, 51 T.C. 830, 840-41 (1969), which had held the American Embassy Cooperative Commissary in Karachi, Pakistan, to be an "agency," as follows:

> [T]he commissary was an agency of the United States. It was engaged in governmental rather than commercial functions, since its sole purpose was to contribute to the efficiency and convenience of the personnel of Government organizations with missions in Pakistan.

The Court of Claims emphasized the elements of control and effectuation of government purposes in identifying an "agency." *Accord, Kalinski v. Commissioner of Internal Revenue*, 528 F.2d 969 (CA 1 1976) (holding U. S. Air Force Europe Child Guidance Center an "agency" for purposes of subsection 911(a)(2), I.R.C.); *McComish v. Commissioner of Internal Revenue*, 64 T.C. 909 (1975), *appeal docketed*, No. 76-1486, 9th Cir., Feb. 12, 1976 (holding GTTPI an "agency" for purposes of subsection 911(a)(2), I.R.C.).

[8] Appellants argue that the United States does not have sovereignty over the Trust Territory Government and that the Trust Territory Government not only has sovereignty to levy taxes but, in fact, does levy taxes. They cite *Domenech v. National City Bank*, 294 U.S. 199, 55 S.Ct. 366, 79 L.Ed. 857 (1935), which held invalid a tax imposed by Puerto Rico on branches of a New York national bank, saying "Puerto Rico, an island possession, like a territory, is an agency of the federal government, having no independent sovereignty comparable to that of a state in virtue of which taxes may be levied." They

also cite *Bell v. Commissioner of Internal Revenue*, 278 F.2d 100 (CA 4 1960), which held that an American citizen who was an employee of the Government of American Samoa was an employee of an agency of the United States, noting that in 1900 the rulers of Samoa had ceded absolutely all sovereignty over the islands to the United States. They further cite *Davis v. Commissioner of Internal Revenue*, 30 T.C. 462 (1958), which, as noted by the court in *Bell*, involved an almost identical situation and which also held that the Government of American Samoa was an agency of the United States. These cases would be apposite if sovereignty were the touchstone of power and responsibility for carrying out a governmental function of the United States. However, we have already concluded that it is not.[15]

In view of the foregoing, we hold that the Government of the Trust Territory of the Pacific Islands is an agency of the United States for purposes of subsection 911(a)(1), I.R.C. Thus appellants' earned income was not excludable from gross income.

The judgment below is affirmed.

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15. We note that in *Bell* the Fourth Circuit quoted from *Lassiter v. Guy F. Atkinson Co.*, 176 F.2d 984, 991 (CA 9 1949) as follows:

> The authority to act with the sanction of government behind it determines whether or not a governmental agency exists. The form the agency takes, or the function it performs are not determinative.

IN THE UNITED STATES DISTRICT COURT FOR THE
NORTHERN DISTRICT OF FLORIDA
PENSACOLA DIVISION

PCA 74-15

KENNETH R. GROVES and PEGGY L. GROVES,
Plaintiffs,

vs.

UNITED STATES OF AMERICA,
Defendant.

MEMORANDUM DECISION

(Filed November 21, 1974)

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This matter is before the Court for final decision, the parties having agreed that the Court should make such decision based on the stipulated and undisputed facts in the record, without the necessity of further trial of the suit.

This action was filed on February 13, 1974 by the plaintiffs against the United States of America whereby the plaintiffs seek to recover the sum of $2,545.03, plus interest, for the year 1970 and $1,969.24, plus interest, for the year 1971. Plaintiffs seek recovery of the above amounts based on their allegations that the government of the Trust Territory of the Pacific Islands is not an agency of the United States within the meaning of Section 911 of the Internal Revenue Code of 1954, and, accordingly, such amounts received from that government as income is excludable from gross income for United States income tax purposes.

Plaintiffs timely filed their joint income tax returns for the years 1970 and 1971 and paid the full amount shown to be due thereon. Thereafter, plaintiffs filed claims for refund for the years 1970 and 1971 on the premise that the income which they received from the Trust Territory Government was excludable from their income for United States tax purposes. The claims for refund for both 1970 and 1971 were disallowed by the Internal Revenue Service.

Both plaintiffs, husband and wife, are employed as contract teachers by the government of the Trust Territory of the Pacific Islands.

They have resided in the Trust Territory as bona fide residents since 1967. The defendant has stipulated that during the suit years, 1970 and 1971, plaintiffs were bona fide residents of the Trust Territory pursuant to the residency requirements of Section 911 of the Internal Revenue Code of 1954.

The Trust Territory of the Pacific Islands is a group of more than 2,000 islands and atolls which are situated in the Western Pacific Ocean and include the Northern

Mariana Islands, the Eastern and Western Caroline Islands, and the Marshall Islands. Between World War I and World War II the Trust Territory Islands had been under the control of Japan which had held a mandate over these islands under the now defunct League of Nations. At the end of World War II, the Trust Territory Islands came under the military control of the United States with the defeat of Japan. Following the establishment of the United Nations at the end of World War II, a Trusteeship Council was set up which had jurisdiction over nonself-governing territories, including the Trust Territory of the Pacific Islands. Trusteeship agreements were entered into between the United Nations and those member nations who were in de facto control and possession of such territories following the cessation of hostilities at the end of Word War II.

The United States accepted administrative responsibility for the people of the Trust Territory through a trusteeship agreement with the United Nations Security Council on July 18, 1947. Congress, by joint resolution, authorized the president to approve the trusteeship agreement. Joint resolution of July 18, 1947, c. 271, 61 Stat. 397. Under the trusteeship agreement, the United States, as the administering authority, has full powers of administration, legislation and jurisdiction over the trust territory in order to promote the objectives of the United Nations, namely, the development of the economic, social, political and educational well being of the people of the Trust Territory.

Administration of the trusteeship was vested in the President of the United States by Section 1 of the Act of June 30, 1954, c. 423, 68 Stat. 330 (48 U.S.C. par. 1681(a)), wherein Congress directed—

> That until Congress shall further provide for the government of the Trust Territory of the Pacific Islands, all executive, legislative and the judicial authority necessary for the civil administration of the Trust Territory shall continue to be vested in such person or persons and shall be exercised in such manner and through such agency or agencies as the President of the United States may direct or authorize.

Responsibility for administration of the Trust Territory was divided between the United States Department of Interior and the Department of the Navy until 1962, when President Kennedy, by Executive Order No. 11021, 27 Fed. Register 4409 (48 U.S.C.A. par. 1681 note), redelegated his authority for civil administration of the Trust Territory exclusively to the Secretary of the Interior. Pursuant to this authority, the Secretary of the Interior established a Trust Territory Government which included legislative, judicial and executive branches similar to the governmental setup of the United States. Department of Interior Order No. 2918.

The Executive Branch of the Trust Territory carries out its responsibilities through the High Commissioner of the Trust Territory. The High Commissioner is appointed by the President of the United States with the advice and consent of the Senate. Section 2, Act of May 10, 1967, P.L. 90-16, 81 Stat. 15 (48 U.S.C. par. 1681a).

The legislature of the Trust Territory is known as the "Congress of Micronesia" and consists of two houses, the Senate and the House of Representatives. The legislative powers extend over all subjects of the islands except that the legislative powers are limited in that they may not be inconsistent with treaties or international agreements of the United States, laws of the United States applicable to the Trust Territory, Executive Orders of

the United States President and orders of the Secretary of the Interior. The legislature has general legislative authority except as specifically restricted by the Secretary of the Interior. Department of Interior Order No. 2918, part III.

Every bill which is passed by the Congress of Micronesia has to be presented to the High Commissioner. If the High Commissioner should veto any bill, it is then returned to the Congress. If repassed over his veto, the High Commissioner, if he still does not approve of the bill, must send the bill, with his comments, to the Secretary of the Interior who then shall either approve or disapprove of the bill regardless of the recommendations and action taken by the Congress of Micronesia. Department of Interior Order No. 2918, Part III, Section 13.

The judicial branch of the Trust Territory consists of the High Court for the Trust Territory and such other courts which may be established pursuant to law. The High Court consists presently of a Chief Justice and two Associate Justices who are appointed by the Secretary of the Interior. Department of Interior Order No. 2918, part IV.

Plaintiffs, like other employees of the Trust Territory Government, are paid by checks drawn on the General Fund of the Trust Territory, which fund is composed of both United States Grant funds and locally generated revenues. The Trust Territory Government has control of its Department of Education and the hiring of teachers, and amounts paid them. United States citizens employed by the Trust Territory Government are taxed by it, with the amount based on the gross income of the taxpayer.

Section 911 of the Internal Revenue Code of 1954 permits income received from sources outside of the United

States to be exempt from taxation within the United States except amounts paid by the United States or any agency thereof. Section 911(a)(1).

The defendant has stipulated that the plaintiffs have received income from sources without the United States which are attributable to a period of residency as required within Section 911. Accordingly, the issue presented in this case is the narrow legal determination of whether the government of the Trust Territory of the Pacific Islands is an agency of the United States for purposes of Section 911.

Revenue Ruling 68-608, 1968-2 Cum. Bull. 309, has specifically held that employees of the Trust Territory Government who are citizens of the United States must include income received from that government in their gross income because that government is an agency of the United States. It is with this Revenue Ruling that plaintiffs disagree and upon which the Internal Revenue Service disallowed the plaintiffs' sought-after exclusion. While this ruling is not controlling, it is not without weight and is entitled to respectful consideration. *Davis v. Commissioner*, 30 T.C. 462, *Smythe v. Fiske*, 90 U.S. 374, 382.

From an examination of the trusteeship agreement between the United States and the United Nations, and examination of Executive Order No. 11021 and Secretarial Order No. 2918, the Court holds that the Trust Territory Government is an agency of the United States.

The Trust Territory has been under the direct supervision, control, and authority of the United States since July 18, 1947. Nothing has transpired since that date which would in any way alter the United States' ultimate authority over these islands. At all times since that date the United States has had full power and jurisdiction over

the affairs of the Trust Territory. Presently, full power and authority over the Trust Territory islands is exercised by the Secretary of the Interior. The Trust Territory Government is no more than the agency by which the Secretary of the Interior carries out his authority over the islands pursuant to Executive Order No. 11021.

The purpose of the Department of Interior Order No. 2918, which is set forth in part I of that order, states in pertinent part:

> The purpose of this Order is to delimit the extent and nature of the authority of the Government of the Trust Territory of the Pacific Islands (hereinafter called the Trust Territory), *as it will be exercised under the jurisdiction of the Secretary of Interior* (hereinafter "the Secretary"), pursuant to Executive Order No. 11021 of May 7, 1962 * * *. (Emphasis added.)

It is clear from this statement of purpose of Secretarial Order No. 2918 that the governmental setup of the Trust Territory is merely a means of exercising jurisdiction over these islands by the Secretary of the Interior. The Trust Territory Government is the agency of the United States which carries out the directives of the United States under the United Nations trusteeship agreement. If at any time the Secretary of the Interior desires, for whatever political reason, to cease the present governmental setup of the Trust Territory, he could issue such order and the Trust Territory Government would be abolished.

The High Commissioner is an appointee of the President of the United States with the advice and consent of the Senate. The High Commissioner is directly responsible to and reports to the Secretary of the Interior. Furthermore, the Secretary of the Interior has the ultimate

veto authority over any bills passed by the Congress of Micronesia. The clear implication of this power in the Secretary of the Interior is that the Congress of Micronesia and the High Commissioner derive any authority they possess from the Secretary of the Interior. The ultimate decision making ability and authority rest with the Secretary of the Interior. The Government of the Trust Territory is sanctioned by the United States in accord with the United Nations' policy to permit and encourage self-government and self-development. It is not in any way, nor was it meant to be, an agency outside of the direct authority of the United States.

In *Morse v. United States*, 443 F.2d 1185 (1971), the Court of Claims, in holding the United States Employees Association of Tehran, Iran, to be an "agency" of the United States within the meaning of 26 U.S.C. 911, referred to and relied upon a definition of agency contained in Webster's Unabridged Dictionary (3rd Edition, 1968): "A person or thing through which power is exerted or an end is achieved. . ." It concluded the Association was an agency within the meaning of the statute, even though its employee did not enjoy the benefits afforded by law to Civil Service employees and was not a government employee.

An Army post exchange is an agency, even though the government assumes none of the financial obligations of the exchange. *Standard Oil Company v. Johnson*, 316 U.S. 481.

In *Bell v. Commissioner*, 278 F.2d 100 (4th Cir. 1960), the court held an employee of the government of American Samoa is an employee of an agency of the United States within the meaning of 26 U.S.C. 251(j). In doing so it said:

"The test in determining whether a governmental agency exists is stated in Lassiter v. Guy F. Atkinson Co., 9 Cir., 1949, 176 F.2d 984, 991, 21 A.L.R. 2d 1313, as follows:

> '* * * The authority to act with the sanction of government behind it determines whether or not a governmental agency exists. The form the agency takes, or the function it performs are not determinative. * * *'

See also Kam Koon Wan v. E. E. Black, ltd., 9 Cir., 1951, 188 F.2d 558, 561."

And it went on to point out the fact that American Samoa had its own code of laws, defined branches of government and certain taxing powers is not controlling. What was controlling was that such self-governing local agencies are sanctioned by the United States, with it, through its designated officers, retaining full control. The Court, on page 103, pointed out:

> "Should the Secretary of the Interior, with proper sanction, desire to change the governing procedures of this possession, he need only so instruct its Governor."

Another case so holding is *Davis v. Commissioner*, 30 T.C. 462 (1958).

Plaintiffs point out American Samoa is a territory or possession over which the United States has sovereignty, and contend that since it holds the trust territory in trusteeship and does not have sovereignty, its government cannot be an agency within the meaning of the act. This distinction is immaterial. That the United States, under its trusteeship, does not possess sovereignty over the territory can no more prevent the government created by it pursuant to its trusteeship from being its agency than could the fact that an employees' association or a post exchange is operating on land over which the United States has no sovereignty prevent them from being its agencies.

Here the trust territory government meets the agency test. It is "a person or thing through which power is exerted or an end is achieved." It has the "authority to act with the sanction of government behind it." That plaintiffs are not government employees and do not receive certain benefits as such, or that as employees of the trust territory government they pay it taxes, cannot and does not mean that they are not paid by an agency of the United States within the meaning of the statute here involved.

People of Saipan v. United States Department of Interior, decided by the Ninth Circuit (No. 73-1769) on July 16, 1974, is not applicable here. It involved the application of the Administrative Procedure Act and the National Environmental Policy Act to the trust territory. Nor is *Porter v. United States*, 496 F.2d 583 (Court of Claims 1974), involving the interpretation of contractual rights between a private party and the trust territory government either applicable or persuasive here. Cited by plaintiffs, also, are *Callas v. United States*, 253 F.2d 838, 841-842 (2nd Cir. 1958) and *Brunell v. United States*, 77 F. Supp. 68 (S.D. N.Y. 1948), in which the courts conclude the territory is a foreign country within the meaning of the Tort Claims Act. The holding here is that it is immaterial whether the territory is a foreign country in determining whether the Trust Territorial Government is an agency of the United States within the meaning of the statute here involved.

C.I.R. v. Wolfe, 361 F.2d 62 (1966) points out the original statute exempting from United States taxation

the income earned by American citizens abroad was intended to help our foreign trade and put Americans who work abroad in a position of equality with their competitors by leaving them subject only to the income tax levied on them by the country where they were employed. The exception here involved was placed in the statute because employees of the United States were "usually" exempt from any foreign tax upon their compensation received from the United States. Here plaintiffs are not in competitive foreign trade; while they are taxed by the territorial government, Congress apparently recognized such would occur in some instances.

In a "Supplemental Trial Brief", plaintiffs contend 26 U.S.C. 911 is unconstitutional under the Fifth Amendment because of arbitrary and unreasonable classification of certain taxpayers. As defendant points out, plaintiffs did not include this ground for recovery in their claims for refund so that they seek to place this contention improperly before this court at this time in this proceeding. *Alabama By-Products Corp. v. Patterson*, 258 F.2d 892 (C.A. 5, 1958), aff'd 151 F. Supp. 641; *Ronald Press Co. v. Shea*, 114 F.2d 453 (C.A. 2, 1940), aff'd 27 F. Supp. 857; *Stewart v. United States*, 50 F. Supp. 224 (Ct. Cl. 1943); *Coleman v. United States*, 5 F. Supp. 548 (S.D. Fla. 1934); *First National Bank of Miami v. United States*, 235 F. Supp. 331 (S.D. Fla. 1964).

Judgment will be entered in favor of defendant and dismissing plaintiffs' suit with prejudice and at plaintiffs' cost.

DATED this 21 day of November, 1974.

/s/ Winston E. Arnow
Winston E. Arnow, Chief Judge

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 911 [as amended by Sec. 11(a), Revenue Act of 1962, P.L. 87-834, 76 Stat. 960]. EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES.

(a) *General Rule.*—The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:

(1) *Bona fide resident of foreign country.*—In the case of an individual citizen of the United States who establishes to the satisfaction of the Secretary or his delegate that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during such uninterrupted period. The amount excluded under this paragraph for any taxable year shall be computed by applying the special rules contained in subsection (c).

(2) *Presence in foreign country for 17 months.*—In the case of an individual citizen of the United States who during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during such 18-month period. The amount excluded under this paragraph for any taxable

year shall be computed by applying the special rules contained in subsection (c).

An individual shall not be allowed, as a deduction from his gross income, any deductions (other than those allowed by section 151, relating to personal exemptions) properly allocable to or chargeable against amounts excluded from gross income under this subsection.

• • •

Box 66, Capitol Hill
Saipan, M. I. 96950

January 25, 1976

H. Edward Moore, Jr.
Sherrill and Moore
P.O. Box 1792
Charter Bank Tower, Suite 801
Pensacola, Florida

Dear Mr. Moore,

Ken and Peggy Groves through a mutual friend on Yap sent me a copy of your brief for appellant.

I am in the early stages of contesting my own case with the IRS and so was interested in reading your paper. I have done some thinking of my own, unfortunately without the aid of counsel, on the first decision rendered in their case. I am enclosing the letter which I have written to the IRS. As you will see, it is not the work of a lawyer—and I don't have access to any case books. But perhaps you may find something of interest in my presentation. If it contains anything which would be of assistance to you, by all means use it.

I do not know whether Ken and Peggy's case has yet been heard, so this may come to you too late. Still, I am hoping that it may be a case of better late than never.

Every best wish for success in this case.

Sincerely yours,

/s/ L. J. Kaufer
Leonard J. Kaufer
Headquarters Department of Education

Law Offices of
ROBERT CLIFTON

17261 Sunderland Drive
Granada Hills, Calif. 91344

H. Edward Moore, Jr. Esq
P.O. Box 1792
Pensacola, Fla.

Dear Sir:

I have just read the decision of the U.S. District Court in Groves v. U.S. My oldest son is, like the plaintiff in Groves, a teacher in the Trust Territory and I am trying to help him with regard to his income taxes. I shall greatly appreciate it if you will inform me if you have appealed the Grove case, and if so as to the approximate time that the appeal will be heard and decided.

Thanking you in advance for this information, I am,

Your very truly,
/s/ Robert Clifton

P.S. After 25 years on the bench in Los Angeles I retired and my wife and I joined the Peace Corps and were sent to Micronesia. There, as my assignment as a volunteer I was appointed a temporary judge of the High Court of the Trust Territory and for about two years tried cases and served on the appellate division—all over the Pacific—It was interesting and rewarding.

/s/ R.C.

WALKER AND GANN
Attorneys at Law
332 South Juniper, Suite 109
Post Office Box 788
Escondido, California 92025

Russell W. Walker
Roy H. Gann

Area Code 714
Telephone 743-3022

November 25, 1974

Mr. H. Edward Moore, Jr.
Sherrill & Moore
Attorneys at Law
310 East Government Street
P. O. Box 1792
Pensacola, Florida

Re: Kenneth R. & Pebby L. Groves v.
United States of America
P. C. A. 74-15

Dear Mr. Moore:

For some number of years I was on the staff of the Attorney General of the Trust Territory of the Pacific Islands. While there, and also since my return, I received several contacts from contract employees of the T. T. P. I., regarding representing them in seeking recovery of Federal income taxes withheld and not refunded during their employment with the Trust Territory. As I recall, (and I believe interrogatories were served on the Trust Territory) your office is representing certain plaintiffs in a suit to recover taxes withheld during their employment.

At your convenience, we would very much appreciate your advice as to the current status of the case, and the current position taken by the I. R. S. Also, if possible,

copies of the plaintiffs and defendants pleadings and points and authorities submitted by the government and plaintiffs in support of their respective positions would be very much appreciated. Of course, any costs involved for copying same we would be pleased to remit.

While in the Trust Territory, it was always my general feeling that purely contract employees (as contrasted with I. G. S. employees) should be in the same category as other civilian employees working without the territorial limits of the United States and be governed by the so-called "510" rule, as are United States citizens working on Kwajalein Missile Range for Global Associates. (or Western Electric, etc.)

Your assistance in this matter is very much appreciated.

Very truly yours,

/s/ Russell W. Walker
Russell W. Walker

RWW/ah

DAVID U. TUMIN
Court Executive
Fourth Judicial Circuit of Florida
Room 217, Duval County Courthouse 633-6750
Jacksonville, Florida 32202

February 4, 1975

Larry Hill, Esquire
Sherrill and Moore
Suite 801, Charter Bank Tower
220 West Garden Street
Pensacola, Florida

RE: Groves vs. U. S. A.

Dear Mr. Hill:

Thank you very much for the copy of the Memorandum decision in the above-styled cause. I am sending it this date, to my niece in Saipan, and hope you are successful in the appeal.

With kind regards and appreciation, I remain,

Sincerely,

/s/ David U. Tumin
David U. Tumin

DUT/md

HENDRICKS & TOMLINSON
Attorneys at Law
A Professional Corporation
915 Oak Street
Suite 202
Eugene, Oregon 97401
Telephone (503) 484-2060

Jerry W. Hendricks
R. Sande Tomlinson
David A. Ramstead

March 24, 1975

Mr. Larry Hill
Sherrill & Moore
Attorneys at Law
Suite 801
Charter Bank Tower
220 W. Garden Street
Pensacola, Florida 32598

Re: *Groves* v. *U.S.A.*

Dear Mr. Hill:

This will acknowledge the receipt of your letter and enclosed information which you forwarded to us in the above-entitled matter. Enclosed herein is our check in the sum of $4.00 to cover the xeroxing expenses.

We wish to take this opportunity to thank you for sending us your brief and will be sending our comments after we have had a chance to review it in more detail.

We will keep you advised of any further developments in our pending case involving Mr. J. H. Schenck. In the meantime, if you should have any questions, please feel free to contact us.

Very truly yours,

/s/ R. Sande Tomlinson
R. Sande Tomlinson

RST:kd
Enclosure

TRUST TERRITORY OF THE PACIFIC ISLANDS
Office of the High Commissioner
Saipan, Mariana Islands 96950
Cable Address
Hicott Saipan

June 21, 1974

Mr. Larry Hill
Sherrill & Moore
Attorneys at Law
P.O. Box 1792
Pensacola, Florida 32598

Dear Mr. Hill:

This will acknowledge receipt of the Deposition Upon Written Questions in the matter of Groves vs. United States. The answers will be promptly and carefully prepared. You realize that it will require some time to gather the required information and documents.

It would be appreciated if you would furnish this office with copies of the pleading in this action as the matter is of considerable interest to us.

Very truly yours,

/s/ Richard I. Miyamoto
Richard I. Miyamoto
Attorney General

September 27, 1974

Sherill & Moore Esquires
310 East Government Street
Box 1782
Pensacola, Florida

Re: Groves V. U.S.A. P.C.A. 74-15 U.S. District Court for the Northern District of Florida.

Dear Sir:

I am writing to inquire about the issues and present status of the referenced case.

Thanking you in advance, I am.

Yours very truly,

/s/ Leo McShane
Leo McShane
Chief Public Defender (Temp.)
Box 76 C.H.R.B.
Saipan, Mariana Islands 96950

Law Offices of
MICRONESIAN LEGAL SERVICES CORPORATION
Attorneys and Micronesian Counselors
Cable Address: Microlex

Reply via air mail to Truk Office

February 20, 1976

Larry Hill
Sherill and Moore
Suite 801
P.O. Box 1792
Charter Bank Tower
220 W. Garden Street
Pensacola, Florida 32598

Re: *Groves* v. *U.S.A.*

Dear Mr. Hill:

It is my understanding that you are handling the above-referenced case on appeal to the 5th Circuit Court of Appeals. The *Groves* case is important to our office as we normally recruit a number of American attorneys to work with our program each year.

We would appreciate it if you could let us know what the status of the *Groves* case is. If a decision has been reached by the 5th Circuit, we would appreciate a copy of the decision. If not, has it been argued or set for argument? Finally, could you send us a copy of your brief and that of the I.R.S.

Enclosed is my check for $10.00 to cover any xerox or mailing costs. As surface mail often takes 4 months to get here, could you kindly send things by air mail. Thanks.

Thank you in advance for your help and good luck in *Groves*.

Sincerely,

/s/ Jerry Seck
Gerald L. Seck
Directing Attorney—Truk Office

GLS: cgs
Enclosure

TRUST TERRITORY OF THE PACIFIC ISLANDS
Office of the District Administrator
Truk District
Truk, Eastern Caroline Islands 96942

Commercial
Cable Address
Distad Truk

April 18, 1975

H. Edward Moore, Jr.
Attorney at Law
P. O. Box 1792
Pensacola, Florida

Re: Groves vs. U.S.

Dear Mr. Moore:

There is a large group of American Contract employees who are vitally interested in the Groves vs. U.S. lawsuit. Has the recent decision been appealed? If not, would your firm be interested in a class action against I.R.S.?

I would appreciate any information you might have.

Sincerely,

/s/ Jack Layne
Jack Layne
District Attorney, Truk

COMMITTEE PRINT

94th Congress)
1st Session)

MANAGEMENT OF PUBLIC WORKS PROGRAMS IN THE TRUST TERRITORY OF THE PACIFIC ISLANDS

A STAFF REPORT

PREPARED AT THE REQUEST OF
HENRY M. JACKSON, Chairman

COMMITTEE ON INTERIOR AND
INSULAR AFFAIRS
UNITED STATES SENATE

(Seal)

FEBRUARY 1975

Printed for the use of the
Committee on Interior and Insular Affairs

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COPY

December 19, 1974

The Honorable Rogers C. B. Morton
The Secretary of the Interior
Washington, D. C. 20240

My dear Mr. Secretary:

As you know, the Senate Committee on Interior and Insular Affairs is conducting a review of the management of the public works programs being carried out in Micronesia and related matters.

The staff team which recently visited Micronesia advises me that in the course of their investigations they have found that considerable uncertainty exists concerning the accountability of officials of the Trust Territory Government under Federal laws and regulations governing the use of Federal funds and property. In order to facilitate the Committee's consideration of the findings of the investigation thus far and in preparation for oversight hearings to be scheduled in the next session of the Congress, I believe this matter should be clarified.

I am, therefore, requesting you to obtain an opinion of the Solicitor of your Department or, if necessary, of the Solictor General concerning the applicability of Federal law and regulations to officials of the Executive Branch of the Government of Micronesia. In particular, the opinion should state whether the provisions of relevant portions of Titles 31, 40 and 41 of the U. S. Code and the Federal regulations promulgated pursuant to those portions are applicable to employees of the Executive Branch of the Trust Territories who are appointed by the President or who are employed as civil servants, consultants, or contract employees either by the Department of the Interior or by the High Commissioner.

In addition to a formal legal opinion, I would appreciate a summary description of the existing legal accountability of such employees for the stewardship of Federal funds and property under both Federal and Micronesian law.

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I hope you will prepare this information as expeditiously as possible so that the Committee can have it available for early hearings.

Sincerely,

Henry M. Jackson
Chairman

HMJ:ddn

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UNITED STATES DEPARTMENT OF
THE INTERIOR
Office of the Solicitor
Washington, D.C. 20240

In Reply Refer to:
DGL-T CBC 93713

January 14, 1975

Honorable Henry M. Jackson
Chairman
Committee on Interior and Insular Affairs
United States Senate
Washington, D.C. 20510

Dear Senator Jackson:

This is in further reply to your letter of December 19, 1974, in which you asked for a Solicitor's opinion concerning the applicability of Federal laws and regulations to officials of the executive branch of the Government of the Trust Territory of the Pacific Islands (Micronesia). We realize that there is some confusion on the subject and we are happy for the opportunity to clear the matter up.

At the outset it must be understood that Micronesia is not a territory or possession of the United States. The United States asserts no claim of sovereignty over it. Sayre, "Legal Problems Arising From the United Nations Trusteeship System" 42 Am. Jour. Intl. Law, No. 2. April 1948. In fact, it has been held to be a foreign country. *Callas* v. *United States,* 253 F. 2d 838 (2d Cir. 1958); *Brunell* v. *United States,* 77 F. Supp. 68 (D.C., S.D.N.Y., 1948).

The United States administers the Trust Territory pursuant to the provisions of a 1947 Trusteeship Agreement with the United Nations Security Council which authorizes, among other things, the United States to extend, as it may deem appropriate, its laws to Micronesia. This provision of the Agreement is not self-executing. U.S. laws must be specifically extended to Micronesia by the U.S. Congress before they will be applicable there. The U.S. Congress similarly has provided that until it legislates further on the subject, all executive, legislative and judicial authority necessary for the civil administration of the Trust Territory is vested in such person or persons and in such manner and through such agency or agencies as the President of the United States may direct or authorize. 48 U.S.C. 1681. The President, by Executive Order 11021, has designated the Secretary of the Interior to exercise this authority, and the Secretary in

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turn has established a purely local government with executive, legislative and judicial branches. Secretarial Order 2918, as amended.

The courts have held that the Trust Territory Government, as thus established, is not an agency or instrumentality of the Federal Government but is a separate and distinct legal entity with semi-sovereign powers to sue, be sued and to contract in its own right and name. See, *Porter, et al.* v. *United States,* Ct. Cls. No. 111-73 (1974); *People of Saipan* v. *Morton, et al.,* 502 F. 2d 90 (CA 9, 1974), pet. for cert. filed November 20, 1974.

There are over 7,000 people employed in government service in Micronesia. Of these only 155 are Federal employees. As such, they are subject to the Federal civil service laws and regulations. They are in a sense, there-

fore, agents of the United States assigned, however, to act as officials in a foreign government, discharging the obligations of the United States under the Trusteeship Agreement pursuant to which we are required to develop the inhabitants toward self-government.

There are an additional 462 U.S. citizens employed under contract by the Trust Territory Government. These are Trust Territory—not Federal—employees and are in no way related to the Federal establishment. Virtually all the rest of the Government employees, or about 6,600 are native Micronesians.

Congress annually appropriates to the Department of the Interior the monies necessary to meet the expenses of administering the Trust Territory, including grants to the Trust Territory, which in addition to local revenues, provide for the support of its government functions.

Regarding these grant funds the Comptroller General, by opinion dated June 11, 1957, B-131569, has said:

> . . . [E]xcept for the amounts budgeted and appropriated for the United States High Commissioner and for the Judiciary, the major portion of such appropriations constitute grant funds to supplement local revenues to enable the trust territory civil government to operate essential governmental functions.
>
> The rule is well-settled that grant funds which are transferred to one of the States of the United States become property of the transferee, and are not subject to the statutory restrictions which may exist with respect to the expenditure of appropriated moneys unless they are made a condition of the grant. . . As a corollary to that rule, it would seem to follow that funds appropriated in the nature of unconditional grants to the trust territory when paid over to the trust territory civil government and mingled with local revenues lose their character as public funds.

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From what has been said, therefore, it is clear that the Government of the Trust Territory is not a Federal agency or instrumentality, and the Federal funds that are granted to it to support its governmental functions, when paid over and commingled with local revenues, lose their character as public or Federal funds. Accordingly, it is equally clear that Federal laws and regulations relating to the handling of and accounting for Federal funds and to the contracting practices by Federal agencies are no more applicable to the Trust Territory than they would be to a State of the Union or its officials or agencies. This Department has long held, for example, that the Federal Procurement laws, Title 41 U.S.C., and regulations thereunder are not applicable to the territories or possessions of the United States. E.g., Solicitor's Opinion M-36713 (1967). Nor is the Comptroller General inclined to disagree with our position that they are not applicable to the Trust Territory. Opinion letter B-162910, Jan. 17, 1968. Similarly, the provisions of Title 31 of the U.S.C. relating to the handling and accounting by Federal agencies of public funds would be inapplicable, at least to the funds granted to run the government of Micronesia. These, as the Comptroller General notes, cease to be Federal funds upon being receipted for and commingled with the local revenues.

The situation with regard to Title 40 of the United States Code, particularly the Federal Property and Administrative Services Act of 1949, as amended, is somewhat different. Here the Congress has specifically authorized the Secretary of Interior to acquire excess equipment, material and supplies without reimbursement or transfer

of funds when required by the Department for operations conducted in the administration of the Trust Territory. 48 U.S.C. 1685. In the case of property thus acquired, the Department remains the accountable agency, and it may only be used and disposed of in accordance with applicable Federal law and regulations. Receipts from the disposition of such property belong to the United States and must be paid into the U.S. Treasury.

In addition, the Act provides for the disposition of foreign excess property. 40 U.S.C. 511-514. Foreign excess property is defined as "any excess property located outside the States of the Union, the District of Columbia, Puerto Rico, and the Virgin Islands." 40 U.S.C. 472 (f).

The authority given to executive agencies to dispose of foreign excess property is discretionary and very broad. It may be sold, exchanged, leased or transferred for cash, credit, other property; for foreign currencies, credits or other substantial benefits; and it may be abandoned, destroyed or donated if it has no commercial value or the estimated costs of its care and handling would exceed the estimated proceeds from its sale.

Excess property for the Trust Territory has been acquired under both of these authorities. However, in recent years, as the Trust Territory Government has come to be recognized as a separate, *sui juris*, semi-sovereign legal entity and not a Federal agency or instrumentality, it has acquired

most of its excess property in its own name under the latter authority, primarily from military sources in Southeast Asia. Property once thus acquired belongs to the Trust Territory—not the Federal—Government, and generally may be used and disposed of by that government

in its own name and right. Such disposals are not subject to Federal regulation, and any proceeds belong to the Trust Territory Government.

Finally, you have asked for a summary description of the existing legal accountability of the Trust Territory employees for the stewardship of Federal funds and property under both Federal and Micronesian law. Aside from the legal requirements regarding accountability for Federal property which we have already mentioned, the "Manual of Administration for the Trust Territory of the Pacific Islands" which is promulgated by the High Commissioner and has the force and effect of law as it relates to the rules, practices and policies in the management and administration of the affairs of that government, contains quite detailed instructions and guidelines. Chapters 1-3 of Part 278 of the Manual dealing with Property Accountability and Responsibility provide an example and are enclosed for your information. With regard to the handling of funds there is also enclosed for your information Chapters 6 and 7 of Part 250 of the Manual relating to Administrative Control of Funds and Internal Audits. These enclosures are intended to be illustrative only of the high degree of performance and accountability required of Trust Territory employees. In short, it may be stated that the restrictions and requirements of Federal laws and regulations are regularly required to be applied and practiced by the Government of the Trust Territory even though they may not be legally applicable under Federal law to that government.

In addition to the above, and as a further assurance that the property and money which go to the Trust Territory will be properly managed and accounted for, the U.S. Congress requires the General Accounting Office to audit all financial transactions of the Trust Territory in

accordance with the Budget and Accounting Act of 1921, as amended, and the Accounting and Auditing Act of 1950. 48 U.S.C. 1683. And these audits are conducted, though only periodically. Finally, in 1973, the Congress expanded the duties of the Government Comptroller of Guam to include audits of all accounts in the Trust Territory. He is required to bring to the attention of the High Commissioner and the Secretary of Interior all failures to collect monies due to the government and the expenditures of funds or uses of property which are irregular or not pursuant to law. He also is required to file an annual report of the fiscal condition of the Trust Territory showing receipts and disbursements, including any comments on irregularities and recommendations for improvements. This report is submitted to Congress. 48 U.S.C. 168(a)-(j). The first of such reports should be due in the very near future.

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If you have any further questions on this matter, please feel free to contact C. Brewster Chapman, Jr., Assistant Solicitor, Territories who will give you whatever assistance he can. His number is Code 183 Extension 5216.

Sincerely yours,

/s/ Kent Frizzell
Solicitor

Enclosures
As stated

In the Supreme Court of the United States

OCTOBER TERM, 1978

KENNETH R. GROVES AND PEGGY L. GROVES, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Robert H. Bork,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-427

KENNETH R. GROVES AND PEGGY L. GROVES, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

The sole issue in this federal income tax case is whether the Government of the Trust Territory of the Pacific Islands is an "agency" of the United States within the meaning of Section 911 of the Internal Revenue Code of 1954, as amended (26 U.S.C.), so as to make the salaries paid by it to petitioners ineligible for the exclusion provided by that statute for earned income from sources outside of the United States. In this refund suit brought by petitioners, who were employed as teachers by the Government of the Trust Territory of the Pacific Islands, the district court (Pet. App. A24-A34) and the court of appeals (Pet. App. A1-A23) held that the Trust Territory Government was an "agency" of the United States so that their salaries paid by that government were not excludable from gross income under Section 911.

1. Section 911(a)(1) of the Code provides an exclusion from gross income for earned income received from sources outside of the United States. There are three requirements for qualification under the statute: (1) the amounts sought to be excluded must be from sources outside the United States; (2) during the entire period in question, the taxpayer must be a bona fide resident of a foreign country; and (3) the amounts must not be paid by "the United States or any agency thereof" (Pet. App. A35). There is no dispute that petitioners met the first two requirements of the statute; the question is whether they met the third requirement.

1. The courts below correctly held that the Government of the Trust Territory of the Pacific Islands is an "agency" of the United States within the meaning of Section 911(a)(1) of the Code. The jurisdiction of the United States over the Trust Territory of the Pacific Islands derives from the Trusteeship Agreement between the United States and the United Nations. That agreement provides that the United States shall have "full powers of administration, legislation, and jurisdiction over the territory" (Pet. App. A6). The administration of the Trusteeship was vested in the President of the United States by Section 1 of the Act of June 30, 1954, 68 Stat. 330 (48 U.S.C. 1681(a)), in which Congress directed (Pet. App. A6; footnote omitted):

> That until Congress shall further provide for the government of the Trust Territory of the Pacific Islands, all executive, legislative and judicial authority necessary for the civil administration of the Trust Territory shall continue to be vested in such person or persons and shall be exercised in such manner and through such agency or agencies as the President of the United States may direct or authorize.

In 1962, the President delegated exclusive authority to administer the Trust Territory to the Secretary of the Interior (Pet. App. A6-A7). The Secretary of the Interior thereupon established the Government of the Trust Territory of the Pacific Islands, pursuant to Department of Interior Order 2918 (Pet. App. A7). The Government of the Trust Territory, comprised of an executive, a legislative, and a judicial branch, remains under the direct control of the United States.

The Executive authority is vested in a High Commissioner, who is appointed by the President of the United States with the advice and consent of the Senate (Pet. App. A7; 48 U.S.C. 1681a). The legislature of the Islands, although elected by local citizens, is limited in its lawmaking functions to passing laws not inconsistent with treaties or international agreements of the United States, laws of the United States applicable to the Trust Territory, Executive Orders of the President of the United States, and Orders of the Secretary of the Interior (Pet. App. A7). The judicial branch of the Government is headed by a High Court composed of three justices appointed by the Secretary of the Interior (Pet. App. A7-A8). Furthermore, the overwhelming percentage of funding of the Trust Territory Government (98 percent in 1971 and 94 percent in 1972) is provided by appropriations and grants from the United States (Pet. App. A10, A19).

In sum, the Trust Territory Government was created by the United States for the purposes of carrying out its responsibilities under the Trusteeship Agreement. The powers of the Government are derived solely from the United States. The Trust Territory Government is an

"agency" of the United States within the meaning of Section 911.[1]

2. Contrary to petitioner's contention (Pet. 7-8), the decision below does not "usurp" the power of Congress. Indeed, the decision is in accord with those of other courts construing the term "agency" as used in Section 911 and other provisions of the Internal Revenue Code. See, *e.g.*, *Kalinski* v. *Commissioner*, 528 F. 2d 969 (C.A. 1) (United States Air Force Europe Child Guidance Center is an "agency" of the United States under Section 911); *Bell* v. *Commissioner*, 278 F. 2d 100 (C.A. 4) (Government of American Samoa is an "agency" of the United States under 26 U.S.C. (1952 ed.) 251).[2]

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

NOVEMBER 1976.

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[1] *Porter* v. *United States*, 496 F. 2d 583 (Ct. Cl.), and *People of Saipan* v. *United States Dept. of Interior*, 502 F. 2d 90 (C.A. 9), upon which petitioners rely (Pet. 8), are distinguishable. Those cases respectively held that the Trust Territory Government was not an "agency" of the United States for purposes of contract or the National Environmental Policy Act of 1969. In the latter case, the court recognized that the status of the Trust Territory Government might be resolved differently for tax purposes (*id.* at 95).

[2] In *McComish* v. *Commissioner*, 64 T.C. 909, on appeal, C.A. 9, No. 76-1486, the Tax Court also held that the Government of the Trust Territory of the Pacific Islands was an "agency" for purposes of Section 911.